CFPB Symposium: Small Business Data Collection (Section 1071)

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When the Dodd-Frank Act was signed into law on July 21, 2010 probably no one envisioned that one of its provisions related to the collection of small business data would still be unimplemented more than nine years later. That provision, Section 1071, states that its purpose is "to facilitate enforcement of fair lending laws and enable communities, governmental entities and creditors to identify business and community development needs of women-owned, minority-owned, and small business." 15 U.S.C. 1691c-2(a). Few would disagree with the laudable purpose of the provision, but getting to a rule that would allow lenders to effectively compile meaningful data that meets this purpose has been challenging. To that end, the Bureau should issue a proposed rule that is clear, relatively easy for lenders to implement and provides information that third parties can understand and analyze while at the same time maintaining the privacy of small businesses and lenders.

The Bureau can meet the purpose of Section 1071 by issuing a simple, workable definition of small business that both lenders and small business applicants can follow, and by closely adhering to the language of Section 1071 related to the categories of information collected. Getting a rule in place expeditiously that may not be perfect, but accomplishes the primary purpose of the provision, should be a priority. A rule will promote small business lending and identify community needs and opportunities by providing lenders demographic data by geography. This will aid better understanding where the lending community can better serve specific markets and allow lenders to benchmark

their own small business lending against the industry. Below are some of the primary issues the Bureau should consider in issuing an effective rule.

Setting a Workable Definition of Small Business

First and foremost, the Bureau should make it clear that the provision relates to small businesses only, and not to all commercial loan applicants. Since the purpose of the Section 1071 is to help facilitate and monitor small business lending to women-owned and minority-owned small businesses, the Bureau should resolve an inconsistency regarding applicability in two separate provisions of Section 1071. The purposes provision states "women-owned, minority owned, **and** small business" (15 U.S.C. 1691c-2(a))(emphasis added), while the next provision related to information gathering states "women-owned, minority-owned **or** small business**"** (15 U.S.C. 1691c-2(b))(emphasis added). Including larger corporations and larger commercial loans, which by definition would not be relevant to small business lending, would substantially increase the regulatory burden on lenders and not facilitate the purpose of the provision to provide meaningful tools to monitor, identify and bring enforcement actions against discriminatory lenders. Accordingly, the Bureau should limit the scope to what will make implementation, monitoring and enforcement practical.

Second, the Bureau should apply a clear definition of a small business. Section 1071 defines small business as "having the same meaning as the term 'small business concern' in section 632 of this title." 15 U.S.C. 1691c-2(h)(2). If the Bureau applies the same definition that is applied in the Small Business Act, this would mean that lenders would have to look through more than 49 pages of entity categories known as North American Industry Classification System (NAICS) codes compiled and organized by the Small Business Administration to determine if a company is a small business. The definition of a small business varies greatly by its NAICS code. For example, an Apiculture (beekeeping) small business must have less than $1 million in gross revenues, while a Food Product Machinery Manufacturer must have 500 or fewer employees to be a small business. *U.S. Small Business Size Standards* (April 19, 2019). The lack of a consistent definition across business sectors will make it difficult for lenders and others to analyze the data and look for common trends across markets.

Alternatively, applying a fixed gross revenue benchmark that defines a business with gross revenues of $1 million or less as a small business would be clear and could be consistently applied by lenders across institutions. Moreover, this definition would also be aligned with the definition of small business in both the Equal Credit Opportunity Act (ECOA) and the Community Reinvestment Act (CRA). Regulation B, which implements the ECOA, requires lenders to make more expansive disclosures to small businesses with revenue $1 million or less in the previous year. 12 C.F.R. 1002.9(a)(3)(i). Similarly, the CRA requires banks to report loans to small businesses, defined as those with revenue of $1 million or less, as part of the bank's CRA obligations. 12 C.F.R. 228.12(g).

Defining small business as those with a $1 million annual gross revenue cap would cover a significant majority of small businesses. According to the Bureau, businesses with gross revenue of $1 million or less covers approximately 95% of all firms, over 97% of all minority firms, and over 98% of all women-owned firms. CFPB's Request for Information Regarding the Small Business Lending Market, 82 Fed. Reg 22319 (May 15, 2017).

Providing Clear Guidance on What Constitutes Minority or Women-Owned and Exempt Organizations

The Bureau should provide clear and concise guidance on which owners should be considered for the purposes of determining if a business is minority or women-owned, as well as which owners are principal owners, for the purposes of information collection related to race, sex and ethnicity. 15 U.S.C. 1691c-2(e)(2)(G). The simplest approach would be for any natural person (not companies, trusts or other legal entities) to be considered for purposes of minority or women-owned status self-reported by the applicant, while only natural persons with a significant ownership interest (25% or more) would have the option of providing demographic information about themselves as principal owners. On the application form, lenders could include instructions that the race, sex and/or ethnicity of principal owners should only be listed if they own 25% or more of the company. Guarantors should not be included unless they have an ownership interest for either determination of minority or women-owned status or data collection. This approach is consistent with the purpose of the statute

which is to help identify business and community development needs and opportunities.

Applying a lower-threshold definition that would require lenders to make an effort to collect demographic information on all owners, even those who do not have a significant ownership interest, would be cumbersome and increase the decision time and cost of the loans. It might also have the unintended consequence of discouraging small businesses from applying because of the additional burden of collecting this information and asking even those with a small stake in the company for personal information.

It would also be inconsistent with the language in section 1071 related to the "[f]orm and manner of information" that the lender should report the race, "sex and ethnicity of the **principal** owners of the business." 15 U.S.C. 1691c-2(e)(2)(G)(emphasis added). Limiting collection of demographic data to those with a significant ownership interest would also align with the Treasury Department's Financial Crimes Enforcement Network ("FinCEN") issued rule requiring lenders to identify natural persons that own 25% or more of the equity interest of an entity. 31 CFR Parts 1010, 1020, 1023, et al.

Similarly, lenders should only be required to report credit extended where there is an owner that is a natural person who can self-identify their race, ethnicity or gender in keeping with the basic purpose of section 1071 to accurately monitor and facilitate enforcement of fair lending laws and identify business and community needs. In that respect, the Bureau should consider excluding a variety of organizations from the reporting requirements such as trusts, non-profit organizations, companies owned by other corporations and publicly traded companies. All of these organizations would complicate reporting, increase costs and the ability of those assessing the data to compare loans to similar applicants across the country.

Ensuring that the information collected and how it is stored and used promote affordable loans and meaningful disclosure

In determining what data points lenders need to collect, the Bureau should balance the need for small business loans to be affordable and processed quickly against the purpose of Section 1071 to provide a level of detail that will allow

“communities, governmental entities and creditors” to evaluate the data collected. 15 U.S.C. 1692c-2(a). The fields listed in the Section 1071 include:

- The number of the application and the date it was received:
- The type and purpose of the loan or credit being applied for;
- The amount of credit or credit limit applied for, and the approved amount;
- The type of action taken and the date the action was taken;
- the census tract of the principal place of business of the applicant;
- the gross annual revenue of the previous fiscal year of the applicant; and
- the race, sex and ethnicity of the principal owners of the business.

15 U.S.C. 1692c-2(e)(2)(A)-(G).

Although the Bureau has the ability to require disclosure of “any additional data that the Bureau determines would aid in fulfilling the purposes of this section,” the Bureau should avoid the temptation of adding multiple data fields until data collected from these fields enumerated can be analyzed over time. 15 U.S.C. 1692c-2(e)(2)(H). This will allow the Bureau to consider the effectiveness of the data specified in the statute and the cost to a business of providing this data. The Bureau should, however, consider including as a data point the Annual Percentage Rate (APR) which will allow a more meaningful comparison by geographic market of the cost of credit.

The Bureau should also limit the type of credit for which these data fields are collected to new applications for credit, and not include borrower requests to increase a line of credit or lender reactive changes to a line of credit based upon a borrower’s change in financial circumstances. This additional information related to line increase or lender actions would complicate reports and require lenders to provide updates based upon additional snapshots in time that would be difficult for lenders to implement and for third parties to analyze. Limiting the data to new applications would also be consistent with the Home Mortgage Disclosure Act (HMDA) reporting which provides information about mortgage loans at their inception and does not require reporting on subsequent loan modifications.

The Bureau should also clarify that lenders can rely on the data points, such as revenue, provided by the applicant and are not required to do additional due diligence to validate. This will allow lenders to make credit available to eligible borrowers quickly, effectively and affordably. Applicants are required by law to provide accurate information on a credit application and reliance by the lender on information provided by a business about its size is consistent with official regulatory interpretations of Regulation B. Official Interpretation, 12 CFR 1002.9(a)(3).

There are, however, data points, even among those listed in the statute, that cannot be reported or would be difficult to report because of the very nature of the product involved. For example credit card applicants do not generally have an opportunity to apply for a specific amount of credit. For this reason, the reporting requirements should provide for flexibility in the event that a data point is not applicable to a specific application or product. Credit card lenders can provide the initial credit limit approved for the borrower which will allow third parties to compare approved credit amounts across the industry. Similarly, small businesses typically apply for credit cards and unsecured loans for general business purposes and do not list a specific subcategory for their purpose. Many small businesses do not want to provide additional information about the purpose because it would disclose proprietary information. For this reason, "general business purpose" should be an acceptable purpose listed in the rule.

Finally, the Bureau should provide lenders the option of either limiting access to the information required in Section 1071 to underwriters or providing an appropriate notice to the applicants that access is not limited. The Bureau should also provide, as part of its rule, a model notice for lenders to provide to the applicant concerning underwriter access, in the event a lender does not restrict access.

Section 1071 provides two alternatives, allowing lenders to either limit underwriters' access to the information provided by the applicant or provide the applicant with a disclosure that the lender does not limit access to the data, but cannot discriminate on the basis of the information. 15 U.S.C. 1691c-2(d)(1) and (2). By making it clear that lenders have this option, the Bureau will facilitate timely and effective implementation. Doing so would also be consistent with the

application process under the analogous HMDA. HMDA does not require mortgage lenders to restrict access and makes it clear on form 1003 that it is the applicant's decision whether to provide additional demographic information. HMDA struck the balance that although some applicants may decide not to provide demographic information out of fear the information will be used for underwriting or shared with others, the current fair lending and privacy laws and requirements are clear that mortgage lenders cannot use the information in underwriting or share with third parties. The Bureau should strike the same balance here and provide small business lenders a safe harbor to make access decisions and provide appropriate notice.